

MINUTES

MONTANA SENATE 57th LEGISLATURE - REGULAR SESSION COMMITTEE ON TAXATION

Call to Order: By **VICE CHAIRMAN ALVIN ELLIS JR.**, on March 7,
2001 at 8:00 A.M., in Room 405 Capitol.

ROLL CALL

Members Present:

Sen. Bob DePratu, Chairman (R)
Sen. Alvin Ellis Jr., Vice Chairman (R)
Sen. John C. Bohlinger (R)
Sen. Mack Cole (R)
Sen. Pete Ekegren (R)
Sen. Jon Ellingson (D)
Sen. Bill Glaser (R)
Sen. Dan Harrington (D)
Sen. Emily Stonington (D)

Members Excused: None.

Members Absent: None.

Staff Present: Lee Heiman, Legislative Branch
Deb Thompson, Committee Secretary

Please Note: These are summary minutes. Testimony and
discussion are paraphrased and condensed.

Committee Business Summary:

Hearing(s) & Date(s) Posted: House Bill 486, 2/22/2001;
House Bill 143, 3/2/2001
Executive Action: House Bill 143 9-0; Senate
Bill 486 as amended 9-0
Senate Bill 374 Discussed

HEARING ON HOUSE BILL 143

Sponsor: REP. ROGER SOMERVILLE, HD 78, KALISPELL

Proponents: Kurt Alme, Department of Revenue; George Bennett,
Montana Banker's Association

Opponents: None

Opening Statement by Sponsor: REP. SOMERVILLE presented the bill. He distributed written testimony. **EXHIBIT (tas52a01)** The bill addressed problems with pass through entities, such as S corporations, partnerships and limited liability companies regarding reporting and taxation of income. Essentially, from the increase of these types of businesses being formed, non resident partners have not been filing a Montana individual income tax return. A composite return withholding distributive shares, a consent form required of the shareholder or an estimated tax withheld from the nonresident's share of Montana source income reported on the entities information return, will be required. He distributed composite return data, showing increase growth from 1995. **EXHIBIT (tas52a02)** This bill will help insure that non resident partners in these pass through entities are paying Montana income tax. **{Tape : 1; Side : A; Approx. Time Counter : 0 - 10.1}**

Proponents' Testimony: Kurt Alme, Director of the Department of Revenue, spoke in support of the bill. He described the hard work of the subcommittee that worked on this issue. Those included REP. SOMERVILLE, House Tax Committee with contributions by the Society of CPA's, Banker's Association and Montana Taxpayer's Association. This bill deals with a host of issues related to pass through entities. The key provision deals with non resident compliance which is a problem getting them to pay their fair share of tax. There are two issues, the first is the ability by the Department of Revenue to assert jurisdiction over people outside the state of Montana. The second issue is trying to catch that money before it leaves the state because it is expensive to track folks down to pay. This is simple tax fairness. The resident taxpayers are paying their share but the non resident taxpayers are not. **{Tape : 1; Side : A; Approx. Time Counter : 10.1 - 12.9}**

George Bennett, Attorney for the Montana Banker's Association, spoke as a proponent. He noted that banks are now allowed to create a Sub S corporation. Congress finally allowed banks to take this election. The Sub S theory, if you have a small family owned business, whether a bank or other business, to operate as a partnership they should not be penalized with double taxes that are on corporations. The problem then became, if you elect for federal purposes to be a Sub S and have been using the bad debt reserve, in order to recapture that reserve as income. The state of Montana has never allowed a bad debt reserve, you had to take actual bad debts. One of the problems between the banking industry and the department over whether that was state income or not - this bill resolves that. The shareholders of that

corporation should be allowed to take an allocate portion of the tax credit for taxes paid to another state. This bill now takes care of those two problems. He supported the bill. **{Tape : 1; Side : A; Approx. Time Counter : 12.9 - 15.4}**

Opponents' Testimony: None

Questions from Committee Members and Responses: SENATOR BOHLINGER

asked how many taxpayers were not in compliance. **Mr. Alme** replied that a compliance effort by the department in 1998 discovered approximately \$850 thousand dollars of compliance revenue was found. This effort would not have found all the compliance revenue that was outstanding. If you take the \$850 thousand dollars and divide by the number of pass through entities that existed in 1998 and extrapolate that forward to the numbers of pass through entities we have in 2001 you get \$1.85 million annually.

SENATOR ELLINGSON noted if this \$1.85 million were collected with the passage of this bill, what would be the prospects of back tax collections. **Mr. Alme** replied the bill would have insignificant impact on back taxes. The crux is in education and having composite returns filed prospectively without additional compliance work by the department. **{Tape : 1; Side : A; Approx. Time Counter : 15.4 - 20}**

SENATOR STONINGTON asked for clarification on the registration. **Mr. Alme** replied that the only way to track pass through entities was through the Secretary of State's Office which only had names and social security numbers, not addresses. Once the department got the information, enforcement was still a problem. The bill will provide two options. One is called a consent agreement, acknowledging their shareholders have a tax obligation to pay and waive their objection for jurisdiction of the state of Montana. A composite return is the other option. This way it is taken care of at the partnership level, the S Corporation level, and the individuals don't have to bother. The department is trying to be flexible and break into this process and not be punitive and thereby assume there is an education effort. That is why the consent agreement is in there to educate out of state or non resident shareholders and partners. In two years, if there is still a compliance problem, this can be revisited. In waiving their personal jurisdiction, it will put the shareholders on notice they have an obligation to file. The hammer is, if they don't do either one, we will require the entity to withhold that individual at the top income tax rate. That is the tool used to get them to do one of the other choices. There will still be a problem of enforcement, although the barrier of jurisdiction will be removed. **{Tape : 1; Side : A; Approx. Time Counter : 20 - 25}**

Closing by Sponsor: REP. SOMERVILLE closed. He noted the effective date was January 1, 2003. The concern is in letting people know about the process. {Tape : 1; Side : A; Approx. Time Counter : 25 - 29.5}

HEARING ON SENATE BILL 486

Sponsor: SENATOR BOB DEPRATU, SD 40, WHITEFISH

Proponents: Aidan Myhre, Montana Chamber of Commerce

Opponents: None

Opening Statement by Sponsor: SENATOR DEPRATU presented the bill. He explained the bill deals with people who have been involved with successful companies and may want to move to Montana, bringing their stock options and cash in to start a new company. We see this happening in Bozeman already. This would allow them to transfer their stock into the new company, or sell it and within one hundred and eighty days either invest in that new company or help an existing company expand. This investment would have to create five new jobs in one form or another. Either an existing company would have to be able to add five jobs or a new company would create five new jobs. The jobs would have to pay a livable wage and the company would have to continue for at least 18 months to hold on to this credit. If the company maintains existence for five years and maintain the employment of the five employees, that is when they can dispose of that stock and have a real tax savings. He distributed amendments that would change the bill from 150% of livable wage to 175%. Using the figures from the Department of Revenue it would give a wage per hour of \$9.71. **EXHIBIT (tas52a03)**

Proponents' Testimony: Aidan Myhre, representing the Montana Chamber of Commerce, said she thought this was a good bill. Access to capital is one of the greatest concerns of businesses in Montana.

Opponents' Testimony: None

Questions from Committee Members and Responses: SENATOR COLE asked if there was any indication as to use of the program. SENATOR DEPRATU said he kept hearing about shortage of capital in the state as one of the main problems encountered when considering any economic development. The idea was formed when a Cisco employee had commented about leaving the company and

building a business in Montana. There are people out there who would like to move some of their money here. The bill requires them to have their tax revenues here. We need higher income tax earners here in Montana. **{Tape : 1; Side : B; Approx. Time Counter : 7 - 9}**

SENATOR ELLINGSON asked if this would cover someone selling common stocks that may have capital gains and be able to transfer the proceeds of the stock into such an endeavor. **SENATOR DEPRATU** replied that the bill was that broad based, if they would actually create the five jobs. The purpose is to build a viable company that will actually create jobs.

SENATOR STONINGTON said she liked the idea. This was a beneficial concept for the economy that doesn't compete with existing businesses. It provides incentives for good paying jobs.

Closing by Sponsor: **SENATOR DEPRATU** closed. He urged a do pass. **{Tape : 1; Side : B; Approx. Time Counter : 9 - 11.4}**

EXECUTIVE ACTION ON HOUSE BILL 143

SENATOR STONINGTON MOVED DO CONCUR ON HB 143. She clarified that the withholding from the highest taxable rate would not apply until 2003. However, compliance with either filing composite returns or informational returns would take place in the next year, 2002. The reason for that was to give them a year for the educational purposes.

The question was called. The motion **PASSED** unanimously. **SENATOR COLE** will carry the bill.

EXECUTIVE ACTION ON SENATE BILL 486

SENATOR BOHLINGER MOVED DO PASS SB 486. **SENATOR EKEGREN** asked if a livable wage had been determined. **SENATOR DEPRATU** said the Department of Revenue has defined the amount of money that would take, also defined by the federal government, for two people to live in Montana. That came out \$11,700 dollars a year. That seems a little tight. The 150% was too low. The 175% was more tolerable which is \$9.71 an hour. The reason for not setting a specific dollar amount is that this figure changes annually. This would allow it to grow without having to come into the statutes to change it. There is a difference between very rural and metro but that mechanism would not be practical. **{Tape : 1; Side : B; Approx. Time Counter : 11.4 - 17.7}**

The question was called on the amendment. The motion was **ADOPTED** unanimously. **SENATOR BOHLINGER MOVED THE BILL AS AMENDED.** The motion **PASSED** unanimously 9-0.

EXECUTIVE ACTION ON SENATE BILL 374

SENATOR DEPRATU MOVED DO PASS ON THE AMENDMENT. He explained the amendment would allow a continuation of the cap for two years to give a chance to work on the issue. The amendment adds to the bill that if the property should be sold before the two years are up then the selling price becomes the new appraised value to the new owner. **EXHIBIT (tas52a04)** He pointed out there was a serious problem throughout the state as we are seeing people move in who are raising the bids on property by 300-400% of what the values were two years ago. This is good if the person sells, but there are a lot of people who do not want to move out. There are older people who are on fixed income where money doesn't mean anything to them when it comes to their place. They can be offered a million dollars for their place but they would rather spend their remaining years on their property. If that valuation has gone from \$150,000 to \$1 million dollars - they are unable to pay the taxes on it. They are forced out. This is a disruption of their life style and what they had hoped would be a very enjoyable time in the waning years of their life. This bill would give us two years to address that problem.

SENATOR HARRINGTON described a lady who had come to testify during the Special Session who owned 90 acres of lake shore property on Whitefish Lake. He felt really bad for her due to the increase of her property taxes. He said he would like to have that problem. The point is the property is worth millions and millions of dollars. She doesn't want to pay the taxes but he could not understand passing the cost back to the taxpayers who live in a tiny house somewhere in Kalispell. **SENATOR STONINGTON** clarified that the parcels addressed in this bill were five acres or less. **{Tape : 1; Side : B; Approx. Time Counter : 23.9 - 30}**

Lee Heiman clarified the average value of the improvements would be determined. He explained the amendment #037402. **SENATOR DEPRATU** said this would help Montana people with modest homes who had their property for a long time and were on property that had greatly inflated value, it doesn't matter if it is on Flathead Lake or next to a golf course. The bill helps someone who is in modest circumstances. Then should someone buy the property and build a mansion, they would pay the higher tax. This would help those with limited and modest income stay in their homes when they are on high value property. It is not a rich person's bill.

It has not hurt the counties collect their tax revenues. He urged passage of the amendment and the bill. **{Tape : 2; Side : A; Approx. Time Counter : 0 - 6.7}**

SENATOR EKEGREN said he was in favor of the bill as a two year study bill, as there is a problem. He had trouble with the bill. A lot of people who bought property on the lake, even five or ten years ago, they did it because they wanted to live there and it was done as an investment. Now they are seeing the values of their investment. He pointed out a problem treating people differently. We all resent what is happening with the influx of people moving into the state, but there is a problem treating California people different than Montana people. It is unfair to discriminate against people just because they come in here with money and buy property. **{Tape : 2; Side : A; Approx. Time Counter : 0 - 8.3}**

SENATOR ELLIS noted that passing the bill without the amendment was unthinkable. It doesn't solve the problem but would allow more time.

SENATOR BOHLINGER called the question on the amendment. The amendment was **ADOPTED** 8-1 with **SENATOR ELLINGSON** voting no.

SENATOR ELLIS MOVED THE BILL AS AMENDED. He said this was not a study bill but it would allow for one, which would be addressed in HB 616.

SENATOR STONINGTON noted this bill would put back into law, something that was taken out. She thought the reappraisal wouldn't occur for two more years and wouldn't affect anything anyway. She stated it would put back into law a preferential treatment. **SENATOR DEPRATU** said it was his understanding that with the sunset at this time, it would go back to the inflated values that were in place. There would be a huge jump from the current inflated values, under the present appraisal. **SENATOR STONINGTON** asked if this had already occurred since it was put in effect last June and the assessments were just going out then. **SENATOR DEPRATU** replied they would lose their 75% of the value of the regular appraisal. **SENATOR GLASER** commented it was taken away during the Special Session but implementation was delayed until December 31 of this year. He noted this would be a major issue with devastating consequences for Montana property taxpayers.

SENATOR ELLIS pointed out if you read subsection 3, item 5 of the amendment, page 2, it says: beginning January 2001, the Department of Revenue shall administer and supervise a program for reevaluation, all taxable property within classes 3, 4 and

10. A comprehensive written reappraisal plan must be promulgated by the department. The reappraisal plan adopted must provide that all class 3, 4 and 10 property in each county be revalued by January 1, 2003 and phased in each of the succeeding six years. If a percentage of change for each year is not established, then the percentage of phase-in for each year is 16.66%

SENATOR BOHLINGER pointed out that **Mr. Follet**, who had testified during the hearing, was sitting on a valuable piece of real estate and we should all be so fortunate to make investments that mature as well as his has. The attempt to provide a tax shelter, or tax relief, is applaudable but in doing to it disrupts the free flow of tax policy. The solution perhaps, for a parcel such as **Mr. Follet**, is to have an amendment that would establish value for tax purposes at the time you acquired the property. **SENATOR DEPRATU** clarified this was addressed in the amendment. **SENATOR COLE** said he would supply a list of the counties and the impact. He asked for some examples from **Mr. Heiman** to clarify how this would work. *{Tape : 2; Side : A; Approx. Time Counter : 22.2 - 25}*

SENATOR STONINGTON said she would like to understand how this would work on valuable homes on small tracts of land.

The committee decided to continue executive action after addressing concerns.

ADJOURNMENT

Adjournment: 9:35 A.M.

SEN. BOB DEPRATU, Chairman

DEB THOMPSON, Secretary

BD/DT

EXHIBIT (tas52aad)